Reg T and the Freeriding Rule

Reg T governs cash accounts and the amount of credit that broker-dealers can extend to investors for the purchase of securities. Violations occur when new buy trades are not properly covered by settled funds. Reg T violations typically occur in cash accounts in two common situations:

- Cash deposits via check or ACH are reversed due to insufficient funds
- Overspending the account as a result of price movement in the security purchased

Check or ACH Reversals

If there's a cash deposit and the deposit is reversed, then previous purchases may be left unpaid. In such cases, replacement funds need to be deposited within a day or two via wired funds. If a trade correction or liquidation occurs instead, the account will likely be imposed with a 90-day cash-up-front restriction.

Overspending Because of Price Movement

If an account overspends its available cash, the overbuy will need to be canceled by a trade correction before T+3 to avoid a cash-up-front restriction. If you choose to liquidate, the trades will need to be placed by T+2 for the liquidation to settle before the Reg T date of the overdraft. In a cash account, you must liquidate something else besides that which is tied to the cash call itself; if not, it's considered a freeride violation.

Freeriding Defined

Violations occur when you buy a security in a cash account that lacks sufficient settled funds and then sell the same security before depositing funds to pay for its purchase. This violation can occur whether the purchase and sale occur on the same day or on different days. On May 28, 2024, the Reg T payment period shrinks from T+4 to T+3, which is the date any freeride transaction must be funded to alleviate it.

Example: A client starts the day with $50 of settled cash in their account and buys $500 of ABC stock. The $450 difference needed to cover the trade is due by the settlement date on T+2. By the end of the day, the client still hasn't deposited the outstanding balance they owe but sells their ABC shares for $1,000. This is a freeriding violation since the client sold the stock before paying for the purchase.

Consequences: Freeriding results in an immediate 90-day cash-up-front restriction—it means that the good faith relationship in the cash account has been removed, so money needs to be in the account to fund new trades on the trade date. If insufficient cash exists to fund new trades in a restricted account, it means the client will lose that portion that isn't sufficiently funded on its settlement date.

Note: Liquidating out of a cash call can be done, but customers can't make a practice of it, defined by doing that three or more times in a rolling 1-year period, after which the account will be imposed with a 90-day cash-up-front restriction.

Stock Settlement – Moving to T+1

The U.S. financial services industry, in coordination with applicable regulators, is implementing a shortened settlement cycle on May 28, 2024. The new trade date plus one (T+1) cycle will apply to most U.S. financial products and replace the current trade date plus two (T+2) cycle. This new cycle will allow investors quicker access to funds and help reduce credit, market, and liquidity risks for securities transactions. All applicable timelines noted above have been adjusted to align with this new cycle.

For more information about T+1, please refer to our Frequently Asked Questions in the Quick Links section.

For more detailed information: SEC.gov | Updated Investor Bulletin: Trading in Cash Accounts

Please contact your Client Service Advocate with any questions.